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No. 97-1553

In the Supreme Court of the United States

OCTOBER TERM, 1997

AVROM R. VANN AND SHIRLEY E. VANN, PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the district court had jurisdiction over this suit for refund of tax attributable to a partnership item.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A11) is unpublished, but the decision is noted at 135 F.3d 768 (Table). The opinion of the district court (Pet. App. A1-A10) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 18, 1997. The petition for a writ of certiorari was filed on March 18, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Relevant portions of the Internal Revenue Code are set forth at Pet. App. A12-A13 and in the Appendix, *infra*, 1a-2a.

STATEMENT

1. Petitioners Avrom and Shirley Vann filed a joint income tax return for 1983 reporting $12,546 in income attributable to Mr. Vann's participation in a partnership known as Kent Associates II (Pet. App. A2; C.A. App. 152-160). Kent Associates II was a partner in a partnership named Securities Group 1980, which in turn was a partner in a partnership named The Securities Group (*ibid.*).

On October 15, 1987, the Internal Revenue Service sent The Securities Group a Notice of Final Partnership Administrative Adjustment (FPAA) that disallowed a $225,682,465 interest expense deduction claimed on the partnership return for 1983. The deduction was disallowed because it resulted "from pre-arranged, rigged and sham transactions in U.S. Treasury bills and securities" (Pet. App. A2; C.A. App. 246, 248-249). The mailing of the FPAA commenced the running of the 150-day period within which suit could be commenced to contest the proposed adjustment. 26 U.S.C. 6226(a), (b). No such action was filed and the administrative adjustment of the partnership return therefore became final.

The disallowance of the claimed deduction increased the taxable income of The Securities Group and thereby increased the distributive shares of taxable income to each of the partners, including Securities Group 1980. The increase in

the taxable income of Securities Group 1980 flowed through to Kent Associates II and to each of its partners, including Mr. Vann. As the result, his distributive share of partnership income from Kent Associates II was increased by approximately $40,000 (Pet. App. A3).

The Internal Revenue Service notified petitioners on August 22, 1990, that additional tax was due for 1983 in the amount of $17,568. The Service thereafter assessed the additional tax, plus $17,222.61 in interest, on September 17, 1990. These sums were collected through a levy on petitioners' bank account (Pet. App. A3). Petitioners then brought this suit in federal district court seeking a refund of taxes.

2. The district court dismissed the refund suit. Section 7422(h) of the Internal Revenue Code provides that "no action may be brought for a refund attributable to partnership items * * * except as provided in section 6228(b) or section 6230(c)." 26 U.S.C. 7422(h). Although Section 6228(b) permits a refund suit for taxes attributable to a partnership item if a partner has filed a request for administrative adjustment with the Service, the district court found that exception inapplicable to this case because petitioners had not filed any such request (Pet. App. A7-A8). The court further noted that, while a refund suit could be brought under Section 6230(c)(1) if the Service had erroneously computed a mathematical adjustment to the partnership return, that exception was also inapplicable here because no such error had occurred and petitioners had not contended to the contrary (Pet. App. A8-A9). The district court therefore dismissed the action for lack of subject

matter jurisdiction. Having done so, the court did not reach the question raised by petitioner as to whether the taxes they owed had been timely assessed.

3. The court of appeals affirmed the judgment of the district court in a one-sentence order (Pet. App. A11).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Under 26 U.S.C. 7422(h), a partner may sue for refund of tax attributable to a corrected partnership item only when a request for administrative adjustment of the partnership return has been disallowed (26 U.S.C. 6228(b)) or when the Secretary has failed correctly to compute the mathematical adjustment that flows to the partner's return from a final partnership adjustment (26 U.S.C. 6230(c)). Neither of those circumstances is present here.

a. Partnerships are not directly subject to the federal income tax. Instead, each partner is liable for the tax that results from the income attributable to his or her allocable share of the partnership activities. Partnerships nevertheless must file annual information returns that report each partner's distributive share of partnership income or loss. See 26 U.S.C. 701, 6031; 26 C.F.R. 1.701-1, 1.6031-1(a)(1); *United States* v. *Bayse*, 410 U.S. 441, 448 (1973). To achieve consistent treatment of all partners, and to reduce the burden of duplicative proceedings, Sections 6221-6233 of the

Internal Revenue Code provide a single, unified administrative and judicial proceeding for review of the partnership return. See Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, § 402(a), 96 Stat. 648-669; H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 599 (1982). Under these provisions, adjustment of a "partnership item"—such as items of income or loss—must be made in the unified proceeding available only at the partnerhip level. 26 U.S.C. 6231(a)(3); 26 C.F.R. 301.6231(a)(3)-1(a)(1)(i); *Randell* v. *United States*, 64 F.3d 101, 107-108 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996).

To audit a partnership return under these procedures, the Internal Revenue Service must send notice to the partners of the commencment of the audit.[1] 26 U.S.C. 6223(a)(1). The "tax matters partner," who has authority to act on behalf of the partnership in its dealings with the IRS (26 U.S.C. 6231(a)(7)), is responsible for keeping each partner informed of the progress of partnership proceedings (26 U.S.C. 6223(g)). Any partner, however, has

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[1] If the partnership has more than 100 partners, the IRS need only notify partners with at least one percent profits interest in the partnership, except that groups of partners having, in the aggregate, at least a five percent profits interest may request notification. Unless the IRS is furnished with the names, addresses and profits interests of indirect partners, a partner that is a "pass-thru partner"—such as a partnership, estate, trust, Subchapter S corporation or nominee—has the obligation to forward, within 30 days, any notice concerning a partnership administrative proceeding to the indirect partners (26 U.S.C. 6223(h)). See 26 U.S.C. 6223(b), (c)(3).

the right to participate in the administrative proceedings. 26 U.S.C. 6224(a).

If the Service disagrees with any item reported on the partnership return, the Service must send a notice of final partnership administrative adjustment (FPAA) to each partner entitled to notice before making any assessment attributable to the disputed item. 26 U.S.C. 6223(a)(2), (d)(2). The tax matters partner has 90 days from the mailing of this notice to file a petition for judicial review of the administrative determination. 26 U.S.C. 6226(a). If the tax matters partner does not file such a petition within that period, any notice partner or 5-percent group has a further 60 days after the close of the 90-day period within which to bring such a suit. 26 U.S.C. 6226(b). If such a petition is filed, all affected partners are treated as parties. 26 U.S.C. 6226(c), (d). The court then has jurisdiction to determine all partnership items to which the FPAA relates and the proper allocation of such items among the partners. 26 U.S.C. 6226(f). When a valid petition is not filed, however, the tax treatment of partnership items as administratively adjusted by the IRS is deemed conclusively established as a matter of law. *Randell* v. *United States*, 64 F.3d at 108.

During the 150-day period that a petition may be filed to contest an FPAA, the Service generally may not assess a deficiency attributable to a partnership item. If such an action is filed, the Service may not assess the deficiency until the decision of the reviewing court has become final. 26 U.S.C. 6225(a)(1), (a)(2). If a proceeding is not begun, however, the restrictions on assessment expire (26 U.S.C. 6225(c)) and the Service is free to

make assessments against individual partners that flow from the "computational adjustment" (26 U.S.C. 6231(a)(6)) that results from the adjusted treatment of the partnership item in the FPAA. In any suit seeking recovery of a tax paid upon such an assessment, the treatment of partnership items in the FPAA "shall be conclusive." 26 U.S.C. 6230(c)(4).

b. To complement the foregoing provisions and to ensure a single, unified determination of partnership items, the normal provisions governing refund suits are expressly rendered inapplicable to claims for refunds attributable to partnership items. 26 U.S.C. 6230(d)(6), 6511(g). Section 7422(h) of the Code contains an express limitation on a taxpayer's ability to maintain a refund suit in respect of a partnership item. That Section, which is entitled "Special rules for actions with respect to partnership items," provides that "[n]o action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)." 26 U.S.C. 7422(h).

As the courts below correctly concluded, the two statutory exceptions to such refund suits are unavailable on the facts of this case. Section 6228(b) is inapplicable because it permits a suit for refund only when the IRS has failed to allow in full a partner's request for administrative adjustment (26 U.S.C. 6228(b)), and no such request for adjustment was made in this case. Section 6230(c) is inapplicable because it permits a suit for refund only when the IRS has erroneously computed the adjustment on an individual partner's return that results from the final adjustment of the part-

nership item (26 U.S.C. 6230(c)), and no such erroneous computation was alleged to occur in this case. Because neither of these two statutory exceptions apply to this case, the courts below correctly dismissed petitioners' refund action.

2. Indeed, petitioners do not contend that either of the exceptions found in 26 U.S.C. 7422(h) applies to this case. Instead, petitioners assert that 26 U.S.C. 7422(h) is inapplicable to this case because their refund suit is based on an error in the assessment procedure rather than on an error in the treatment of a "partnership item[ ]." The courts below correctly rejected that claim.

a. Under the plain language of 26 U.S.C. 7422(h), it is the origin and character of the item of income as a "partnership item[ ]" that determines jurisdiction over a refund suit. The taxpayer's theory of recovery does not affect the jurisdictional limitations of that provision. To achieve the statutory goals of avoiding piecemeal litigation and ensuring a single, unified determination of partnership tax liabilility, courts have consistently held that the statute of limitations on an assessment of tax attributable to a partnership item is an issue to be determined at the partnership level. *Kaplan* v. *United States*, 97-1 U.S. Tax Cas. (CCH) ¶ 50,418, at 88,042 (N.D. Ill. 1997), aff'd, 133 F.3d 469 (7th Cir. 1998); *Thomas* v. *United States*, 967 F.Supp. 505, 506 (N.D. Ga. 1997); *Anderson* v. *United States*, 93-1 U.S. Tax Cas. (CCH) ¶ 50,360, at 88,404 (N.D. Cal. 1993), aff'd, 50 F.3d 13 (9th Cir. 1995) (Table); *Crowell* v. *Commissioner*, 102 T.C. 683, 693 (1994); *Genesis Oil & Gas, Ltd.* v. *Commissioner*, 93 T.C. 562, 565 (1989). Because the statute of limitations on assessment of a

partnership item is itself a matter appropriately determined at the partnership level, courts have strictly applied 26 U.S.C. 7422(h) to preclude refund suits that are not premised on review of an administrative adjustment request under Section 6228(b) or an erroneous computational adjustment under Section 6230(c). *Kaplan* v. *United States*, *supra*; *Thomas* v. *United States*, *supra*; *Williams* v. *United States*, 97-1 U.S. Tax Cas. (CCH) ¶ 50,444, (E.D. Ky. 1997), appeal pending, No. 97-5820 (6th Cir.); *Anderson* v. *United States*, *supra*.[2]

b. Petitioners err in contending (Pet. 8) that 26 U.S.C. 7422(h) does not apply to a tax attributable to a partnership item that is collected from a partner after the statute of limitations for assessment has expired. It is well established that the general taxpayer refund suit made available

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[2] None of the partners of The Securities Group filed a petition in court contesting the FPAA on any ground. Petitioners wander off the point in noting (Pet. 9) that the Anti-Injunction Act does not preclude the issuance of injunctive relief against collection when the taxpayer shows that the government can not prevail on the merits and that no alternative means exist for challenging the validity of the tax (*South Carolina* v. *Regan*, 465 U.S. 367, 378-379 (1984)). Since the tax at issue in this case has already been collected, there is obviously no basis for invoking equitable jurisdiction to enjoin collection. *Kroger* v. *United States*, 755 F.2d 1094, 1096 (4th Cir. 1985). See also *Singer Mfg. Co.* v. *Wright*, 141 U.S. 696 (1891). Moreover, a suit by any partner would fall within the strictures of the Anti-Injunction Act because he "had earlier opportunities, of which he failed to avail himself, to challenge the partnerships' reported income" (*Randell* v. *United States*, 64 F.3d at 108).

under 28 U.S.C. 1346(a)(1) "must be read in conformity with other statutory provisions which qualify a taxpayer's right to bring a refund suit" and that "the first" of these provisions is 26 U.S.C. 7422 (*United States* v. *Dalm*, 494 U.S. 596, 601 (1990)). The plain language of 26 U.S.C. 7422(h) provides that no action may be brought to recover taxes attributable to partnership items except in limited circumstances that are indisputably not present here. No applicable waiver of sovereign immunity permits a refund suit to proceed in these circumstances.

Moreover, the record of this case does not support petitioner's contention that the statute of limitations had expired before the assessment was made in this case. The statute of limitations for making an assessment of taxes attributable to a partnership item is normally three years from the due date of the partnership return or the time the return is filed, whichever expires later. 26 U.S.C. 6229(a). It is six years in the case of fraud (if the partner is not complicit) or in the case of a substantial omission from gross income. 26 U.S.C. 6229(c)(1), (c)(2). Under 26 U.S.C. 6229(c)(3), the statute of limitations does not begin to run until the partnership files a return. The statute of limitations is tolled during the 150 days an FPAA may be contested in court and until such a court proceeding is final, plus one year, under 26 U.S.C. 6229(d)). Moreover, because it is impossible to make an assessment against an unknown partner, the statute is also tolled during the time an indirect partner is "[u]nidentified" in IRS records and for one year thereafter. 26 U.S.C. 6229(e).

The assessment in this case was made on September 17, 1990 (Pet. App. A3).[3] Petitioners contend (Pet. 3) that the statute of limitations expired on March 13, 1989, one year and 150 days after the mailing of the FPAA. That contention, however, ignores the unexpired portion of the limitations period at the time the FPAA was mailed. 26 U.S.C. 6229(d) only suspends the period of limitations; it does not terminate the limitations period 150 days plus one year after the mailing of the FPAA, as petitioners mistakenly assume. The appropriate method for computing the length of the limitations period is to add the applicable statutory period—whether three years or six—to the tolling period under 26 U.S.C. 6229. Petitioners did not plead or prove the date that the 1983 return of The Securities Group was filed. Consequently, the record does not support their contention that the assessment period expired on March 13, 1989.

Moreover, petitioners failed to show that Mr. Vann, an indirect partner in The Securities Group via Securities Group 1980 and Kent Associates II, had been identified to the IRS as a partner. Unless the IRS already had such information, the statute of limitations on assessing taxes against him was tolled under 26 U.S.C. 6229(e) until his name, address, taxpayer identification number and profits interest were furnished, and for one year there-

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[3] Contrary to petitioners' contention (Pet. 5-6, 7), the district court did not determine that the assessment was untimely. The court merely recounted the contention that it was time-barred (Pet. App. A3, A8, A9) and concluded that a suit brought on that theory did not fall within the grounds permitted by 26 U.S.C. 7422(h) (Pet. App. A9).

after. Petitioners' assertion that the assessment was untimely thus lacks support in the record. The issues for which petitioners seek review (Pet. 5) are therefore not presented on the facts of this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

26 U.S.C. 6229 provides in relevant part:

(a) **General Rule**

Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of—

(1) the date on which the partnership return for such taxable year was filed, or

(2) the last day for filing such return for such year (determined without regard to extensions).

* * * * *

(d) **Suspension when Secretary makes administrative adjustment**

If notice of a final partnership administrative adjustment with respect to any taxable year is mailed to the tax matters partner, the running of the period specified in subsection (a) (as modified by other provisions of this section) shall be suspended—

(1) for the period during which an action may be brought under section 6226 (and, if an action with respect to such administrative adjustments is

brought during such period, until the decision of the court in such action becomes final), and

(2) for 1 year thereafter.

(e) **Unidentified partner**

If—

(1) the name, address, and taxpayer identification number of a partner are not furnished on the partnership return for a partnership taxable year, and

(2)(A) the Secretary, before the expiration of the period otherwise provided under this section with respect to such partner, mails to the tax matters partner the notice specified in paragraph (2) of section 6223(a) with respect to such taxable year, or

(B) the partner has failed to comply with subsection (b) of section 6222 (relating to notification of inconsistent treatment) with respect to any partnership item for such taxable year,

the period for assessing any tax imposed by subtitle A which is attributable to any partnership item (or affected item) for such taxable year shall not expire with respect to such partner before the date which is 1 year after the date on which the name, address, and taxpayer identification number of such partner are furnished to the Secretary.